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FILED ELECTRONICALLY

Marlene H. Dortch
Secretary
Federal Communications Commission
Office of the Secretary
445 Twelfth Street, SW
Washington, DC 20554

Re: *Domestic Section 214 Application for Transfer of Control of the Conrad, Eldora, And Steamboat Rock (Iowa) Exchanges* (WC Docket No. 03-249); *Heart Of Iowa Communications Cooperative and Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom Petition for Waiver of the Study Area Boundary Freeze as Codified in Part 36 and Waivers of Sections 69.3(e)(11) And 69.605(c) of the Commission's Rules* (CC Docket No. 96-45).

Dear Ms. Dortch:

Heart of Iowa Communications Cooperative ("Heart of Iowa") and Iowa Telecommunications Service, Inc. ("Iowa Telecom") (together, "Parties"), by their attorneys, hereby supplement the record in the above-referenced dockets. The Parties have entered into an Asset Purchase Agreement to transfer control of 815 access lines in three rural exchanges in Iowa, *e.g.*, the Conrad, Eldora, and Steamboat Rock exchanges ("Exchanges").

Heart of Iowa serves a cluster of small rural north-central Iowa communities geographically adjacent to the Exchanges, and has overbuilt into the Exchanges using its own facilities. Heart of Iowa successfully acquired the majority of residential and business lines in each of the Exchanges prior to Iowa Telecom's acquisition of the Exchanges from GTE in 2000. Currently, Heart of Iowa serves 77 percent of the 3559 total lines in the Exchanges primarily because of the relative age of GTE's (now Iowa Telecom's) outside plant and resulting challenges faced by GTE and Iowa Telecom in providing new technologies and services. For instance, Heart of Iowa has been able to provide broadband solutions to its customers in the Exchanges, while Iowa Telecom's current facilities have not allowed a similar rollout. This transaction is, therefore, a direct outgrowth of historical events and market realities that predate Iowa Telecom entry into these Exchanges.

Competitive Landscape. The state of Iowa benefits from substantial local competition that is not limited to business and high-volume customers. Heart of Iowa's CLEC success in the Exchanges is representative of the type of competition Iowa Telecom faces in approximately 69 other communities with at least one active CLEC provider. In total, Iowa Telecom serves 294 rural Iowa exchanges. Many of these communities are very small; in fact, more than 75 percent of Iowa Telecom's communities have fewer than 1,000 access lines. *Telecommunications Competition Survey for Retail Local Voice Services in Iowa*, Iowa Utilities Board, at 21 (Jan. 2004) ("*Iowa Competition Survey*").

Heart of Iowa is just one of at least 26 independent LECs that compete with Iowa Telecom through network overbuilds and/or extensions of neighboring exchanges. *Iowa Competition Survey* at 22. In those impacted exchanges, the Iowa Utilities Board ("IUB") has recently calculated that independent LECs, "have gained market share between 13 and 97 percent." *Id.*[1] Importantly, the IUB has recognized that this competition has succeeded even though the independent LEC's "rates are somewhat higher than Iowa Telecom's rates." *Id.* The IUB further concluded that the overbuilders could provide "newer and more advanced facilities that allow them to offer services Iowa Telecom cannot readily match." *Id.*

The map below provides a closer view of the Exchanges and surrounding areas. The pink areas are Heart of Iowa's current exchanges, the green areas are the Exchanges to be acquired, and the gray areas are Iowa Telecom's exchanges. Qwest serves the vast majority of the remaining white areas. Although not presently active in the Exchanges, Qwest provides service to Marshalltown, the closest population center to the Exchanges.[2] In addition, there are other providers, including CMRS providers (U.S. Cellular, and Midwest Wireless) and a cable provider (Mediacom), offering similar services today in the three Exchanges. A complete map of Iowa highlighting the same information is attached to this letter.

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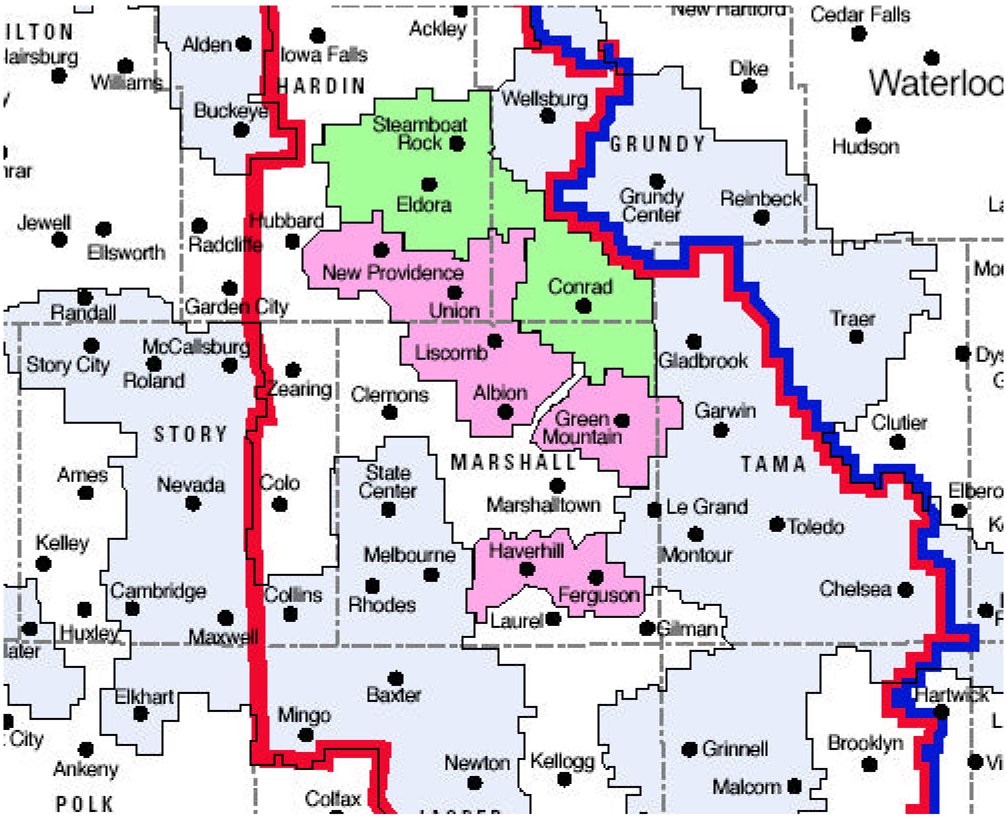
[1] In addition, Iowa Telecom faces further competition from municipal telephone utilities that also provide competitive telephone service using their own networks in at least seven communities with market shares between 29 and 64 percent. *Id.*

[2] Qwest has also asked Iowa Telecom to negotiate an Interconnection Agreement to allow Qwest entry into Iowa Telecom's rural footprint.



The Exchanges serve customers in parts of rural Hardin county (population of 18,000), Grundy county (population of 12,000), and Marshall county (population of 39,000).[3] The Exchanges' three-county area is sandwiched between two large Qwest-dominated urban counties: Polk county to the southwest (population 379,000 including Des Moines) and Black Hawk county to the northeast (population 126,000 including Waterloo).

The potential for competition from current providers in the Exchanges, providers serving adjacent and nearby areas, as well as new and emerging providers effectively eliminates the competitive impact of this covenant. As way of example, the size and proximity of Qwest's properties underscore the rural nature of the Exchanges, the lack of scope and scale available to Heart of Iowa and Iowa

[3] Neither Heart of Iowa nor Iowa Telecom serve Marshalltown (population of 26,000) the largest part of Marshall county.

Telecom in these rural areas, and the potential threat of competitive entry into these communities by Qwest. Overall, Qwest serves over 200 communities in Iowa with a total of 893,000 access lines. Qwest's Des Moines properties alone represent 190,000 access lines. *Iowa Competition Survey* at 19. As a point of comparison, Iowa Telecom only serves 67,000 more lines in the entire state.

Conditions of Asset Purchase Agreement. In order to protect their mutual interests, the Asset Purchase Agreement includes a Noncompetition Covenant that provides:

> "[d]uring the five-year period commencing on the Closing Date, neither Seller nor Buyer shall directly or indirectly engage in serving as a Competitive Local Exchange Carrier (CLEC) for voice in any other exchanges owned by Buyer or Seller. Each party acknowledges that they have entered into this noncompetition covenant as a material inducement to the other party to consummate the transactions contemplated hereby."

The Covenant is Consistent with FCC and Iowa Precedent. The Commission has consistently found that noncompetition covenants are necessary components of similar transactions involving the transfer of customers. Specifically, the Commission "has recognized the acceptability of covenants not to compete where the restraint is: 1) ancillary to the sale of a business; 2) designed to prevent a seller with an ongoing, competing business from impairing the value of the property or business sold by immediately attracting the existing customers of the transferred business; and 3) reasonably limited as to duration and geographic scope." *Application of MCI Communications Corporation, Transferor, and Southern Pacific Telecommunications Corporation, Transferee, For Consent to Transfer Control of Qwest Communications, Inc.*, Memorandum Opinion and Order, 10 FCC Rcd 1072, ¶ 22 (1994).

All three criteria are satisfied in this proceeding. The covenant is clearly ancillary to the sale of Exchanges. Further, the covenant is designed to protect both the buyer and the seller from impairing the value of the properties, and interrelated properties, at issue. A mutual covenant limiting the subsequent actions of both the buyer and seller was approved as part of the Qwest/U S West merger proceeding, under similar circumstances.[4] In that instance, Qwest divested its in-region interLATA

[4] *See Qwest Communications International Inc. And U S WEST, Inc.; Applications for Transfer of Control of Domestic and International Sections 214*

customers to Touch America, but Qwest's out-of-region interLATA customers were not transferred. Under the mutual covenant, Qwest, the seller, was forbidden for a three-year period from competing in any of the thirteen states in the former U S West territory for those customers. Similarly, Touch America, the buyer, was forbidden for a three-year period from competing for the business of the divested Qwest customers in any other state. *Id.*, ¶ 24. Those covenants were limited to the customers and types of services directly impacted by the transaction, *i.e.*, the interLATA customers transferred from Qwest to Touch America.

The impetus behind that mutual restriction was to prevent against a "sham" divesture with perverse and unintended consequences. Touch America needed protection to ensure that Qwest could not simply turn around and re-enter and re-acquire the same properties/customers divested to Touch America after the transaction closed. Equally important, Qwest needed protection to ensure that Touch America did not use the acquired properties/customers as a springboard to acquire closely related Qwest business not directly implicated in the divestiture. Without that dual protection, neither party could have moved forward with the transaction.

Similarly in this instance, it was critical for both Heart of Iowa and Iowa Telecom that protections were built into the arrangement to ensure that neither party could inappropriately or unintentionally benefit from the transaction. Limiting any such protections to the 815 lines directly at issue would have effectively provided no protection to the parties at all. Like Qwest, Iowa Telecom needs assurances that Heart of Iowa will not immediately use the Exchanges as a springboard into additional Iowa Telecom exchanges. At base, Iowa Telecom cannot enter into a transaction, absent contractual protections, that would facilitate further competitive loses in adjacent and nearby exchanges without any countervailing benefit. Further, like Touch America, Heart of Iowa needs to ensure that Iowa Telecom does not re-enter the Exchanges and compete for any of its former customers, not just the 815 lines at issue in this proceeding.[5] In addition, this covenant is limited to the type of

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(Continued . . .)
and 310 Authorizations and Applications to Transfer Control of a Submarine Cable Landing License, Memorandum Opinion and Order, 15 FCC Rcd 11909 (2000).

[5] *See also Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, 13 FCC Rcd 18025, ¶ 153 (1998).

service at issue in the transaction (local exchange operations) and does not limit either party from competing for other services, *e.g.*, DSL, long distance, or Internet services, anywhere in Iowa

The duration of this covenant – five years - was selected based on precedent under Iowa law. *See Uncle B's Bakery, Inc. v. O'Rourke,* 920 F. Supp. 1405, 1433 (N.D. Iowa 1996). The FCC has approved similar covenants for even longer durations in the broadcast context.[6] In *Steele,* the Commission approved a seven-year covenant related to the operation of a FM station that included a geographic limitation of twenty-five miles. *Steele,* ¶¶ 36-37. Both the geographic scope and the seven-year covenant were found to be "reasonably limited in geographic scope and duration."[7]

The geographic scope of this covenant is "any other exchanges owned by Buyer or Seller," on its face this amounts to a limitation that covers all of the Parties' exchanges in Iowa. As a matter of practicality, the covenant was drafted broadly because of the inherent line drawing problems and uncertainties in determining which exchanges of the Parties are implicated by this transaction. Both Heart of Iowa and Iowa Telecom's CLEC entry strategy has been incremental growth into adjacent or nearby exchanges that maximize the use of ILEC facilities. All of Heart

6 *Applications of James U. Steele St. Simons Island, Georgia; Dale Bell St. Simons Island, Georgia; For Construction Permit for a New FM Station; Dale Bell Assignor and WBA Partnership Assignee; For Consent to Assignment of Construction Permit*, Memorandum Opinion and Order, 4 FCC Rcd 4700 (1989); *Applications of Nirvana Radio Broadcasting Corporation; Valley Radio Corporation; For Construction Permit for a New FM Station on Channel 264 in Christiansburg, Virginia*, Memorandum Opinion and Order, 4 FCC Rcd 2778 (1989). On the telephony side, the Qwest/Touch America transaction had a three-year covenant.

7 *Id.; see also Nirvana,* ¶ 8 (upholding five-year covenant that covered all of Blacksburg and Christiansburg, Virginia). In the broadcast context, covenants are typically linked to the duration of a license term; the assumption being that those investments should be protected for a set period. The comparable investment in this instance is the consolidation and integration efforts of Heart of Iowa in the Exchanges and its adjacent exchanges. In addition, Iowa Telecom intends to invest to upgrade and improve its plant in the adjacent exchanges to provide better and additional services. The stranded costs of such investments is up to 10 years, thus the 5-year period at issue in this case is easily within the FCC's broadcast analysis.

of Iowa's properties are in very close proximity to the Exchanges and it is very unlikely that Heart of Iowa would ever be in a position to compete throughout the entire state of Iowa. As such, the Commission should recognize that the covenant does not foreclose any potential competition in the vast majority of exchanges at issue because there is no evidence that either party "would have entered the relevant [exchanges] absent the" covenant.[8]

Realistically the only significant competition would be directly related to the Exchanges and the immediate surrounding counties. The competitive impact of the geographic limitation in this proceeding is thus limited and narrow in scope as required by the FCC. Further, the Commission can rely on well-established antitrust principles in evaluating this covenant, and need not develop its own standards to evaluate such provisions.

Transaction Serves Public Interest. Commission approval of this transaction in its entirety is in the public interest. The transaction is also in the clear interest of the customers in the Exchanges. Without this acquisition, the customers in the Exchanges would be left with two carriers serving a very small number of total lines; neither of which would have the economies of scale or financial incentive to further invest or expand in the Exchanges. Similarly, without this transaction, Heart of Iowa would be blocked from achieving new economies of scale, a more cohesive and rational service area, or administratively simpler operations. Likewise, Iowa Telecom needs to focus its efforts to update and improve its outside plant.

Both companies also will benefit from this transaction, but only if the covenant's protections are maintained because the covenant provides the additional certainty necessary to protect the interest of both carriers and their subscribers. That said,

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8 *See generally Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, For Consent to Transfer of Control*, Memorandum Opinion and Order, 14 FCC Rcd 14712, ¶ 64 ((1999); *see also Applications of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, Memorandum Opinion and Order, 15 FCC Rcd 14032 ¶ 58 (2000) (citing *United States v. Marine Bancorporation*, 418 US 602 (1974); ABA Section of Antitrust Law, Antitrust Law Developments (4th ed. 1997) at 346-50).

this covenant does not foreclose competition in the Exchanges as a number of other competitors currently – or could easily – compete in the Exchanges and the adjacent areas. Both companies are fully aware of those competitive risks, and seek only limited protection to ensure the integrity of this transaction, and avoid circumstances in which the carrier's own actions would result in unwarranted and unintended competitive losses.

Moreover, while this transaction may limit immediate competition between the parties in the short-term, it is a necessary step to allow both companies to invest in their infrastructure and to create more logical operational footprints to encourage future competition and competition with the dominant provider in Iowa, Qwest. This transaction also provides both companies with a better opportunity to improve service and expand offerings, and for Iowa Telecom to reverse the competitive trends recognized by the IUB.[9]

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[9] The overwhelmingly rural nature of these exchanges and the financial and operational realities of both Heart of Iowa and Iowa Telecom further suggest that the Commission should approve this transaction with the covenant. Both the Act and the FCC in numerous contexts have acknowledged that rural is different, and that the competitive dynamic in urban areas cannot necessarily be replicated in all remote and rural areas. For instance, the Act in Section 214 created two different mechanisms to encourage competitive entry. Under that provision, state commissions must allow new competitors in non-rural areas, but has discretion to determine if the public interest is served by competitive entry in rural areas. 47 U.S.C. § 214(e); see *also Federal-State Joint Board on Universal Service,* Recommended Decision, FCC 04J-1, par. 17-18 (Feb. 27, 2004); *Federal-State Joint Board on Universal Service, Virginia Cellular, LLC Petition for Designation as an Eligible Telecommunications Carrier In the Commonwealth of Virginia,* Memorandum Opinion and Order, FCC 03-338 (Jan. 22, 2004). The underlying principle is that additional competition in rural areas is not guaranteed to be in the public interest.

Sincerely,

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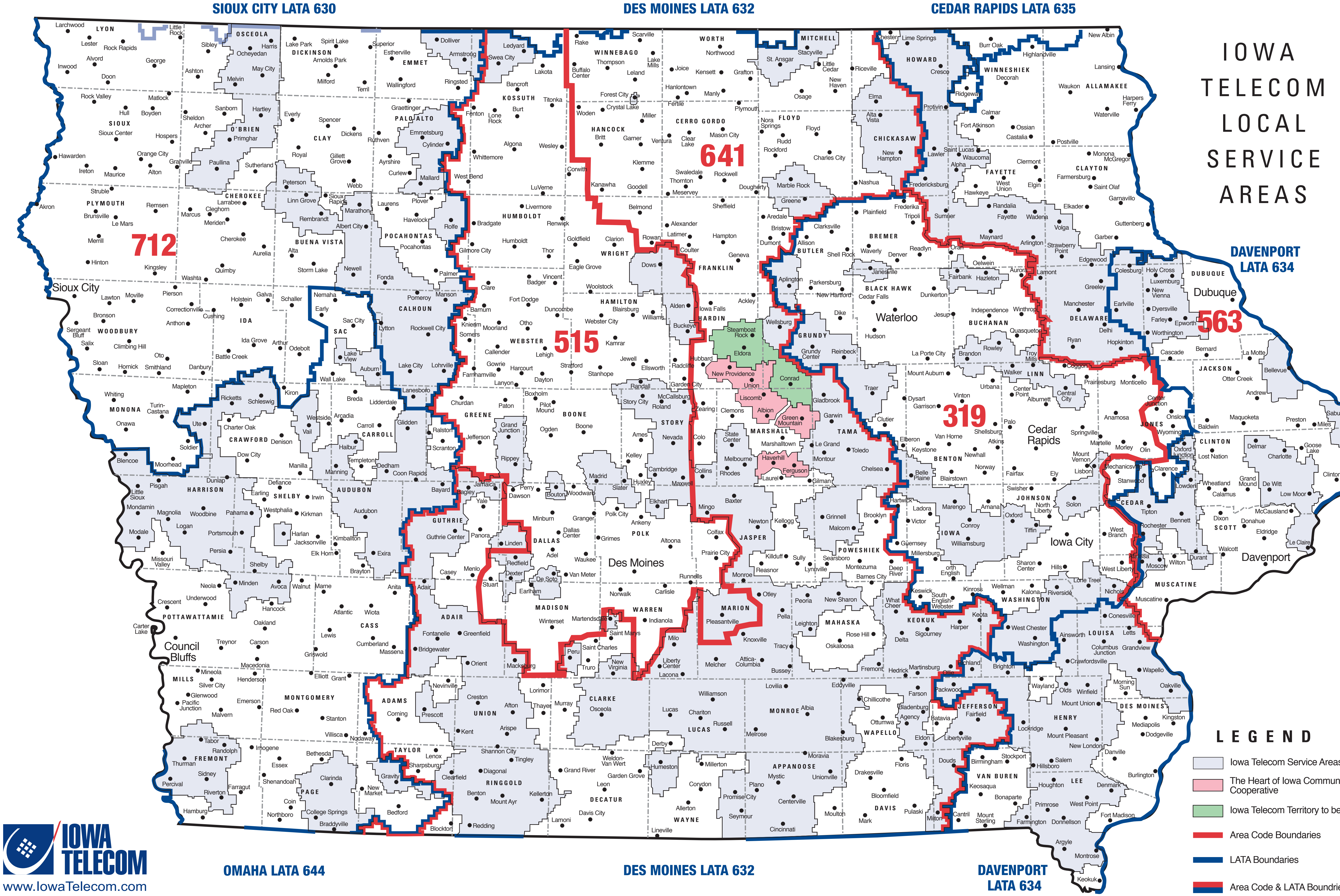
IOWA TELECOM LOCAL SERVICE AREAS



LEGEND

- Iowa Telecom Service Areas
- The Heart of Iowa Communications Cooperative
- Iowa Telecom Territory to be Transfered
- Area Code Boundaries
- LATA Boundaries
- Area Code & LATA Boundries

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